California Film & Television Tax Credit Program

AGREED UPON PROCEDURES

~~November 1, 2009~~ *December 1, 2009*

I. Introduction

The California Film & Television Tax Credit Program provides tax credits for qualified expenditures incurred when producing qualified motion pictures. The tax credits can be used to offset either California personal or corporate income taxes or sales and use taxes. A production company requesting a tax credit must submit an Independent Certified Public Accountant's Report on Applying Agreed-Upon Procedures (the 'Report') to demonstrate compliance with the program's requirements.

II. Statutory References

California Revenue and Taxation Code Sections:

1. 6902.5 (sales and use tax)
2. 17053.85 (personal income tax)
3. 23685 (corporate income tax)
4. California Code of Regulations, Title 10, Chapter 7.75, Sections 5500-5507

III. General

The following agreed-upon procedures are to be performed by a certified public accountant (CPA) with an active California license to perform attest services. The CPA cannot provide production accounting services and agreed upon procedures services to the same production company as per Rule 101 of the American Institute of Certified Public Accountants Code of Professional Conduct and its interpretations and rulings.

The selected CPA must have sufficient knowledge of accounting principles and practices generally recognized in the film and television production industry. The CPA shall read the statute, regulations, guidelines, Qualified Expenditure Charts, Tracking Tips, and all other materials posted on the California Film Commission (CFC) website.

1. The report shall be prepared for the use of the following specified parties:

    a. The production company; and
    b. The California Film Commission

*2.*The CPA's name, address, ~~and~~ telephone number*, California CPA license number or a copy of his or her practice privilege permit.*

3. ~~2.~~ The name of the production and its Credit Allocation Number must also appear on the Report.

4. ~~3.~~ The Report must be dated as of the last day of the performance of all procedures.

5. ~~4.~~ The production company's cost report must be presented in U.S. dollars.

6. ~~5.~~ The production company must provide documentation of all funds expended on the production Including pre-production, production and post-production periods.

IV. Agreed-Upon Procedures

The CPA shall perform the following procedures. Any exceptions are to be listed as a finding in the CPA's report on applying agreed-upon procedures.

Eligibility:

1. Obtain the detailed cost ledger (e.g. Bible) of California Qualified Expenditures and Total Production Expenditures.

2. Obtain from the California Film Commission and read the production company's tax credit application with supporting documentation, including the following: Application Form (CFC Form A), Production Budget, and Independent Film Declaration (CFC Form C), if applicable.

3. Obtain and read the production company's Credit Allocation Letter.

4. Obtain and inspect post-production documents (e.g. facility invoices) evidencing the date the final elements (e.g., final composite answer print, air master, or digital cinema files) were created. Determine and document in the Agreed-Upon Procedures Report the Qualification Period of the production. Confirm that the Qualified Production Period does not exceed 30 months after the date in which the CFC issued the Credit Allocation Letter.

5. Obtain and inspect documentation (e.g. call sheets and/or production reports, shooting schedules) for all principal photography days for the production during the Qualified Production Period. Based upon the inspection of the documentation, state the percentage of total principal photography days occurred wholly in California. (The total principal photography days in California ratio can be obtained by dividing the number of days of principal photography in California by the total number of principal photography days).

6. If the production does not meet the 75% principal photography day test above, perform the following procedures:

   a. Obtain a detailed cost ledger of Total California Expenditures (including qualified and non-qualified expenditures) and the Total Production Budget. State the ratio of Total California Expenditures to the Total Production Budget.
   b. Select a sample of expenditures from the Total California Expenditure population (including qualified and non-qualified expenditures) according to the sampling methodology noted in Appendix A.
   c. For each expenditure item selected, obtain and inspect invoices and cancelled checks or other equivalent documentation. Confirm that the expenditure amount is correct, incurred and paid for services and goods in California.

7. Inspect the detailed cost ledger of Total Production Expenditures to determine that the Total Production Expenditures met the maximum and minimum thresholds for Feature Films, Movies of the Week, Miniseries, Television Series and Independent Films per the statute. If applicable, determine if the completion bond fees were omitted from the Total Production Expenditures to meet maximum thresholds noted above. If so, confirm that the completion bond fees were excluded from California Qualified Expenditures.

8. If the production has not met eligibility standards as noted above, there is no need to continue with the agreed upon procedures. Notify production company management to inform the CFC that they are ineligible for the tax credit program.

<u>Expenditures (other than payroll):</u>

1. Select a sample of expenditures (other than payroll) from the detailed cost ledger according to the sampling methodology noted in Appendix A.

2. For each expenditure item selected in the sample perform the following procedures:

   a. Inspect invoices and cancelled checks or other equivalent documentation. Confirm that expenditure amount is correct, incurred and paid for services and goods in California.

   b. Confirm that the expenditure was not associated with activities specifically excluded by the statute.

   c. Confirm that the expenditure was allowable as defined by statute, CFC guidelines, Tracking Tips, and Qualified Expenditure Charts. In particular, inspect travel costs, living allowances and per diems.

   d. Confirm that the expenditure was not for in-kind services.

   e. Confirm that the expenditure was recorded net of any refunds, credit notes received for discounts, rebates, invoicing errors, insurance claims, and purchase returns, as recorded in the cost report and that completion bond expenditures are reported net after rebate.

   f. Confirm that the expenditure was recorded net of proceeds from any sale of the production assets.

   g. Confirm that the expenditure was not ~~paid~~ incurred prior to the date in which the Credit Allocation Letter was issued.

   h. Confirm that expenditure was not paid more than 30 days after creation of the final elements.

3. Obtain a listing from the production company of assets *with a purchase price over $10,000. The listing should indicate the status of the assets (e.g., destroyed, sold, donated, being held for future productions, given to cast or crew, etc.)* A copy of the listing should be attached to the Report. *For all assets on the listing* ~~which were not destroyed in the process of the making of the production and that are being held for future productions or other purposes and have a purchase price over $10,000, For all assets on the listing~~ perform the following procedures:

   a. Confirm that *the California Qualified Expenditure is the lesser of net cost of the asset after sales proceeds (if assets sold) or* ~~no greater than~~ 20% of the *original* costs of office, post–production, or effects equipment, including but not limited to computers, hardware and relevant components, printers and copiers. ~~being held for future productions or use were included as a California Qualified Expenditure.~~

b. For all other assets, confirm that *the California Qualified Expenditure is the lesser of the net cost of the asset after sales proceeds (if assets sold) or* ~~no greater than~~ 50% of the *original* cost~~s~~ of such *assets*~~.~~ ~~included as a California Qualified Expenditure.~~

c. *Confirm that no assets purchased or given as part of a compensation package for above-the-line personnel are included as a California Qualified Expenditure.*

4. Obtain a listing of *customized* leased or rented items *which are* manufactured, assembled, or fabricated to specification with lease payments aggregating $10,000 or more. Confirm that these items are included on the asset listing noted above (expenditure, procedure 3) if they meet any one of the following four conditions:

   a. If the term of the lease exceeds 75% of the life of the asset;
   b. If there is a transfer of ownership to the lessee at the end of the lease term;
   c. If there is an option to purchase the asset for substantially less than fair market value ("bargain price") at the end of the lease term;
   d. If the present value of the lease payments, discounted at an appropriate discount rate, exceeds 90% of the fair market value of the asset.

   Any such rental or lease agreement that meets the above standards for a capital lease will be considered a purchase and subject to the 50% limitation for purposes of determining California Qualified Expenditures.

5. Obtain a list from the production company of any and all visual effects, digital effects, and/or title companies who worked on the production. Confirm that all listed parties have provided the production company with documentation indicating the total dollar amount of work performed within the state and verify that only the amount of work performed within the state of California is included in the California Qualified Expenditures total.

6. For exceptions noted in the expenditure test in procedure 2 above (not including payroll), for the sample identified in the Top Stratum of Appendix A, adjust the Qualified California Production Expenditures to reflect the results of your testing.

7. For exceptions noted in the expenditures test in procedure 2 above (not including payroll), for the sample identified in the Stratum 1 and Stratum 2 in Appendix A, project the misstatement results of the sample to all items from which the sample was selected. For purposes of calculating the projected misstatement, divide the monetary amount of misstatement of the exceptions identified by the sample population total amount (rate of misstatement). Multiply this rate of misstatement to the total expenditure population from which the Stratum 1 and Stratum 2 sample was selected. Perform the following procedures based upon the results of the calculation of the projected misstatement:

   a. If the projected misstatement does not exceed 2% of Qualified California Production Expenditures, document the projected misstatement in the Report. Do not make adjustments to the California Production Expenditures for the projected misstatement.
   b. If the projected misstatement exceeds 2% of Qualified California Production Expenditures, select a second additional sample according to the sampling methodology noted in Appendix A~~, or if applicable Appendix B,~~ for Stratum 1 and Stratum 2. Recalculate the projected misstatement for the second additional sample. If the projected misstatement for the second additional sample does not exceed 2%, document the projected misstatement in the Report and do not make adjustments to the California Production Expenditures. If the projected misstatement from the second sample selection exceeds 2% of Qualified California Production Expenditures, adjust the Qualified California Expenditures for the average of the two projected misstatements.

Payroll:

1. Obtain detailed payroll reports by employee and work state (e.g. an earning register by employee by work state). Compare and agree the detailed payroll reports for earnings in California to the cost ledger of "qualified wages".

2. Select a sample of employees from the detailed payroll reports for "qualified wages" according to sampling methodology noted in Appendix A. For each employee selected in the sample perform the following procedures:

    a. Inspect time cards, production reports, call sheets or other equivalent documentation. Confirm that wage amount is incurred for services performed in California.

    b. Inspect invoices from "qualified entities". Confirm the date the expenditure was incurred, and that the loan out company name and the amount of the expenditure agrees with supporting payroll records. Confirm that the expenditure was incurred in California.

    c. Confirm that the "qualified wages" only include those expenses listed in Sections 17053.85 or 23685 18 (A) (i)-(iv) and do not include any of the expenses listed in 18 (B) (i)-(iv).

    d. Confirm that only "qualified individuals" received "qualified wages", under the statute.

3. Obtain the final "galley" or checker" of the main (if applicable) and end title credits for the production. Confirm that qualified wages paid to any individuals who also are receiving an on screen producer (e.g., executive, line, co-,associate, visual effects, music, post) credit are considered by the CFC to be within industry standard wage scales or equivalent with other crew in similar positions.

4. For exceptions noted in the payroll test in procedure 2 above, for the sample identified in the Top Stratum of Appendix A, adjust the Qualified California Production Expenditures to reflect the results of your testing.

5. For exceptions noted in the payroll test in procedure 2 above, for the sample identified in the Stratum 1 in Appendix A, project the misstatement results of the sample to all items from which the sample was selected. For purposes of calculating the projected misstatement, divide the monetary amount of misstatement of the exceptions identified by the sample population total amount (rate of misstatement). Multiply this rate of misstatement to the total expenditure population from which the Stratum 1 sample was selected. Perform the following procedures based upon the results of the calculation of the projected misstatement:

    a. If the projected misstatement does not exceed 2% of Qualified California Production Expenditures, document the projected misstatement in the Report. Do not make adjustments to the California Production Expenditures for the projected misstatement.
    b. If the projected misstatement exceeds 2% of Qualified California Production Expenditures, select a second additional sample according to the sampling methodology noted in Appendix A for Stratum 1. Recalculate the projected misstatement for the second additional sample. If the projected misstatement for the second additional sample does not exceed 2%, document the projected misstatement in the Report and do not make adjustments to the California Production Expenditures. If the projected

misstatement from the second sample selection exceeds 2% of Qualified California Production Expenditures, adjust the Qualified California Expenditures for the average of the two projected misstatements.

Related Parties & Other Affiliations:

1. Obtain from the production company a schedule listing:

    a. All related parties
    b. Type of relationship between the related party and the production company
    c. All transactions between the production company and the related party
    d. Nature and amount of the transaction(s)
    e. A listing of all parties with a 5% or greater ownership in or other affiliation with the production company

2. Document in the Agreed-Upon Procedures Report, the name, relationship, nature of transactions and amounts of transactions for all related parties and owners noted in schedule above.

3. Obtain a signed letter from a production company representative stating that the applicant (indicated in the Credit Allocation Letter) has properly disclosed all related parties and related party transactions and that the schedules produced in accordance with item number 1 above are complete and accurate.

4. Compare the list of related parties and owners to the detailed cost report, noting wages and expenditures paid to individuals and entities that are related parties. Perform the following procedures for related party expenditures:

    a. For wages paid to related parties, confirm that no amounts are included in the California Qualified Expenditures.
    b. For non payroll expenditures, inspect documentation to confirm that all related party transactions are made in accordance with an arm's length standard. Whether transactions exhibit arm's length characteristics generally will be determined by reference to the results of comparable transactions under comparable circumstances.

Wrap Up Procedures

1. If applicable, recalculate the 75% spend test (e.g. eligibility procedure number 6) after accounting records are revised for findings in payroll and expenditure procedures. Confirm that 75% of the Total Production Budget was spent for California Qualified Expenditures.

2. Verify the following data requested on the CFC Expenditure Summary Report agrees with the cost report utilized by the CPA for the procedures above, as adjusted for the exceptions noted above:

    a. Qualified Wages - excluding post-production
    b. Qualified Non-wages - excluding post-production
    c. Qualified Wages – post production
    d. Qualified Non-wages – post -production
    e. Total Qualified Expenditures
    f. Total State Income Taxes Withheld
    g. Total Tax Credit Allocation Due

3. The CPA must include the information requested above (wrap up procedures, procedure 2) in the Report utilizing the format in “Exhibit A”.

4. The CPA must indicate on the Report that the specific program minimum and maximum thresholds as applicable to the type of production have been met.